JOBNAME: No Job Name PAGE: 1 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

Sato Kogyo (M) Sdn Bhd v Salini (M) Sdn Bhd

HIGH COURT (KUALA LUMPUR) — ORIGINATING SUMMONS NO 24C-2–07 OF 2013
MARY LIM J
20 NOVEMBER 2013

Banking — Guarantee and indemnity — Performance guarantee — Nature, of — Whether separate from contract between parties

Banking — Guarantee and indemnity — Performance guarantee — On demand guarantee — Documents required to call for payment — Whether payable without proof of any default — Whether payment may be stopped due to fraud or unconscionability — Burden and standard of proof required to prove unconscionability

The defendant had entered into a subcontract with the plaintiff where the defendant was appointed to undertake the preliminary works for a construction project. The subcontract works involved earthworks for which an earthworks permit under s 6(1) of the Land Conservation Act 1960 was required. As part of the conditions of contract, the plaintiff was required to execute a performance guarantee in favour of the defendant. A dispute arose between the parties essentially as to whether the plaintiff could carry on with the works without this permit; who was responsible for procuring this permit; and over the plaintiff's notification of its intention to claim for an extension of time. The plaintiff claimed that any earthworks conducted beyond the conditions were illegal and that the plaintiff had to stop proceeding with the subcontract immediately. The dispute was referred to arbitration. Meanwhile, the defendant wrote to the plaintiff for an extension of the performance guarantee. The plaintiff refused to do so. On 4 July 2013 the defendant gave the plaintiff a written notice of its intention to receive the monies under the performance guarantee. This led the plaintiff to file this action seeking declaratory orders that the performance guarantee was null and void; that the defendant was not entitled to receive the monies under the guarantee; and that the defendant was restrained from receiving such monies. The plaintiff contended that since the arbitral tribunal had found that it would be illegal for the plaintiff to carry on with the works without an earthworks permit, it was unconscionable for the defendant to call on the performance guarantee. The plaintiff claimed that the defendant was not entitled to receive any monies under the performance guarantee as the subcontract had been rendered null and void. The defendant contended that in the second partial award, the

JOBNAME: No Job Name PAGE: 2 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

arbitral tribunal had determined that the plaintiff was in breach of the subcontract.

Held, dismissing the application with costs of RM50,000:

(1) The performance guarantee was a contract entirely separate from the subcontract. It was a contract between the plaintiff and the bank (see para 32).

(2) The performance guarantee here was an on demand guarantee. All that was required to set the obligations of the bank in motion was a written demand accompanied by the original performance guarantee and a written statement stating that the subcontractor was in breach of its obligation(s) under the subcontract. The defendant had done that. That irrevocable promise to pay or meet the demand must be honoured and no restraining orders ought to be made save in very limited circumstances and conditions. Those circumstances or conditions being where there is fraud or where unconscionability is proved (see paras 34–35).

(3) The performance guarantee was an unconditional guarantee. There was no need for the defendant 'to prove or to show grounds for your demand or the sum specified therein'. Once the written demand with the appropriate statement was given, the performance guarantee was activated and the obligations therein must be met (see paras 43–44).

(4) The defendant's demand on the performance guarantee flowed or arose from the award. Such circumstances did not and could not amount to unconscionability; nor did they come anywhere near. Certainly, not on the burden expressed by the Federal Court in *Sumatec Engineering and Construction Sdn Bhd v Malaysian Refining Company Sdn Bhd* [2012] 4 MLJ 1. Something more was required. Otherwise it would be easy to make what is obviously a very serious charge. There must be some fact, material and relevant to show the unconsionability of the demand (see para 47).

[Bahasa Malaysia summary

Defendan telah memasuki subkontrak dengan plaintif di mana defendan telah dilantik untuk menjalankan projek pembinaan. Kerja-kerja subkontrak melibatkan kerja tanah di mana permit kerja tanah di bawah s 6(1) Akta Pemuliharaan Tanah 1960 diperlukan. Sebahagian daripada syarat-syarat kontrak, plaintif perlu menandatangani jaminan prestasi bagi pihak defendan. Pertikaian timbul di antara pihak-pihak terutamanaya sama ada plaintif boleh menjalankan kerja-kerja tanpa permit; siapa yang bertanggungjawab mendapatkan permit; dan mengenai pemberitahuan plaintif-plaintif tentang niatnya untuk meminta lanjutan masa. Plaintif mendakwa bahawa mana-mana kerja tanah yang dijalankan melampaui syarat-syarat adalah tidak sah dan bahawa plaintif hendaklah berhenti daripada meneruskan subkontrak

JOBNAME: No Job Name PAGE: 3 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

dengan serta-merta. Sementara itu, defendan menulis kepada plaintif untuk lanjutan jaminan prestasi. Plaintif enggan berbuat sedemikian. Pada 4 Julai 2013 defendan telah memberikan plaintif notis bertulis tentang niatnya untuk menerima wang di bawah jaminan prestasi. Ini telah membawa kepada plaintif untuk memfailkan tindakan ini memohon perintah-perintah deklarasi bahawa jaminan prestasi adalah terbatal dan tidak sah; bahawa defendan tidak berhak untuk menerima wang di bawah jaminan; dan bahawa defendan dihalang daripada menerima wang tersebut. Plaintif mendakwa bahawa memandangkan tribunal timbang tara telah mendapati bahawa adalah tidak sah untuk plaintif menjalankan kerja-kerja tanpa permit kerja tanah, adalah tidak berpatutan untuk defendan-defendan untuk menarik balik jaminan prestasi tersebut. Plaintif mendakwa bahawa defendan tidak berhak untuk menerima sebarang wang di bawah jaminan prestasi memandangkan subkontrak adalah terbatal dan tidak sah. Defendan berhujah bahawa di dalam separa award kedua, tribunal timbang tara telah menentukan bahawa plaintif telah memungkiri subkontrak.

Diputuskan, menolak permohonan dengan kos sebanyak RM50,000:

(1) Jaminan prestasi adalah kontrak yang secara keseluruhannya berasingan daripada subkontrak. Ia adalah kontrak di antara plaintif dan bank (lihat perenggan 32).

(2) Jaminan prestasi di sini merupakan jaminan atas permintaan. Apa yang diperlukan untuk memulakan kewajipan bank adalah permintaan bertulis diiringi jaminan prestasi asal dan kenyataan bertulis menyatakan bahawa subkontraktor telah memungkiri kewajipannya di bawah subkontrak. Defendan telah melakukan sedemikian. Perjanjian yang tidak boleh ditarik balik untuk membayar atau memenuhi permintaan hendaklah ditunaikan dan tiada sebarang perintah larangan seharusnya dilakukan melainkan di dalam keadaan dan syarat-syarat terhad. Keadaan-keadaan atau syarat-syarat tersebut adalah di mana terdapatnya penipuan atau di mana ketidakpatutan dibuktikan (lihat perenggan 34–35).

(3) Jaminan prestasi merupakan jaminan tidak bersyarat. Tidak perlu bagi defendan 'to prove or to show grounds for demand or the sum specified therein'. Sejurus selepas perintah bertulis dengan kenyataan berpatutan telah diberikan, jaminan prestasi telah diaktifkan dan kewajipan-kewajipan hendaklah dipenuhi (lihat perenggan 43–44).

(4) Permintaan defendan terhadap jaminan prestasi bermula atau timbul daripada award tersebut. Keadaan sedemikian tidak dan tidak boleh membawa kepada ketidakpatutan; ataupun dekat dengan itu. Dengan jelas, bukan atas beban yang dinyatakan oleh Mahkamah Persekutuan di dalam kes *Sumatec Engineering and Construction Sdn Bhd v Malaysian Refining Company Sdn Bhd* [2012] 4 MLJ 1. Sesuatu yang lebih

JOBNAME: No Job Name PAGE: 4 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

diperlukan. Jika tidak, adalah sangat mudah untuk membuat apa yang jelas suatu tuduhan yang sangat serius. Suatu fakta, material dan relevan hendaklah menunjukkan ketidakpatutan permintaan tersebut (lihat perenggan 47).]

Notes

For cases on performance guarantee, see 1(2) *Mallal's Digest* (4th Ed, 2014 Reissue) paras 2741–2744.

Cases referred to

Cygal Berhad v Bandar Subang Sdn Bhd [2004] 3 CLJ 67, CA (refd)

Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 QB 159, CA (refd)

Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd [1995] 1 MLJ 149, SC (refd)

Hemis Interco BV Sdn Bhd v Syarikat Pembenaan Hashbudin (M) Sdn Bhd [1986] 1 MLJ 245; [1986] 1 CLJ 562 (refd)

Karya Lagenda Sdn Bhd v Kejuruteraan Bintai Kindenko Sdn Bhd & Anor [2007] 6 MLJ 72; [2007] 6 CLJ 18, CA (refd)

Kejuruteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd & Anor [2011] 7 CLJ 442, CA (refd)

LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor [2000] 3 MLJ 339; [2000] 3 CLJ 473, CA (refd)

RD Harbottle (Mercantile) Ltd and another v National Westminster Bank Ltd and others [1977] 2 All ER 862, QBD (refd)

Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Pte Ltd & Anor [2002]1 SLR 1, CA (refd)

Sumatec Engineering and Construction Sdn Bhd v Malaysian Refining Co Sdn Bhd [2012] 4 MLJ 1, FC (consd)

Legislation referred to

Arbitration Act 2005 s 38

Land Conservation Act of 1960 s 6(1)

Gideon Tan (Irene Wong with him) (Gideon Tan Razali Zaini) for the plaintiff.
T Kuhendran (Mohd Zayd with him) (Zul Rafique & Partners) for the defendant.

Mary Lim J:

[1] The proceedings before the court are related to a contract awarded to Tindakan Mewah Sdn Bhd and Salini Costruttori SpA who formed a consortium ('consortium') that successfully tendered for the Ulu Jelai Hydroelectric Project Contract TNB No 361/2008: Lot CW-1-Preliminary

JOBNAME: No Job Name PAGE: 5 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

Works ('Ulu Jelai project') in Cameron Highland, Pahang from Tenaga Nasional Bhd.

[2] The defendant in turn entered into a subcontract dated 24 September 2010 with the defendant where the defendant was appointed to undertake the preliminary works for the Ulu Jelai project ('the subcontract'). The scope of the subcontract works involved the building of internal access roads, designing and constructing the engineer's site office and other facilities in Pos Telanok, constructing a working platform area and associated works.

[3] The plaintiff's subcontract works also involved earthworks for which an earthworks permit under s 6(1) of the Land Conservation Act of 1960 (Act 385) was required. Prior to commencement of the earthworks, various preparatory works were also required. This included the establishment of the temporary site office, and the mobilising of sufficient equipment and machineries for setting out and for survey works. The preparatory works were to be conducted stage by stage as the access road was 10,700m long, that is from chainage ('CH') 0 to CH10,700.

[4] As part of the conditions of contract between the parties, the plaintiff was required to execute a performance security in favour of the defendant. It accordingly procured one with Alliance Bank (M) Bhd – see p 2725 Vol 8.

[5] A dispute arose between the parties essentially as to whether the plaintiff could carry on with the works without this permit; who was responsible for procuring this permit; and over the plaintiff's notification of its intention to claim for an extension of time. The plaintiff claimed that it was advised by its then external legal counsel under retainer that any earthworks conducted beyond the conditions were illegal and that the plaintiff had to stop proceeding with the subcontract immediately. Alternatively, the plaintiff was to obtain the requisite indemnities from the defendant.

[6] This dispute was referred to arbitration under cll 18(5)(a),(c) and (d) of the subcontract. These provisions required any dispute between the parties to be settled under the Rules of Arbitration of the ICC International Chamber of Commerce. This meant that three arbitrators would hear the dispute, the seat of arbitration is Singapore, and the governing law would be the laws of Malaysia.

[7] Before the arbitral tribunal, apart from a ruling on a preliminary issue, the parties agreed to a bifurcate hearing, where the issues of liability would be determined first followed by a hearing on the issues of quantum, if necessary. The parties also agreed on the formulation of the issues of liability. A total of

JOBNAME: No Job Name PAGE: 6 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

ten questions were posed for determination. The arbitration then proceeded on these questions.

[8] Meanwhile, the defendant through its solicitors wrote to the plaintiff's solicitors on 4 March 2013 for an extension of the performance guarantee. The plaintiff refused taking the position that since the second partial award had yet to be rendered, there was no basis for the demand.

[9] This led the plaintiff to filing an application before this court seeking declaratory orders on the performance guarantee, that it was null and void and, for an injunction restraining the defendant from calling on the performance guarantee. On 23 May 2013, the parties entered into a consent order where the defendant was allowed to make the call but agreed not to receive the sum under the performance guarantee until the second partial arbitral award was made or issued

[10] After hearing evidence and submissions, the second partial arbitral award was rendered on 27 June 2013. That award can be found at exh 'TTC34' (Vol 11 to the affidavit filed in support of this application).

[11] Specifically, the arbitral tribunal's findings on those ten questions can be found at para 173 of the award, and I have set it out in a table for ease of reading:

Question 1	Finding
The identity of the party responsible contractually for applying for the earthworks permit or permits.	As between the parties to the arbitration, the respondent was the party responsible contractually for applying for the issue of the earthworks permit.
Question 2	**Finding**
Whether the earthworks permit of 12 January 2011 was restricted to an area of 8.5 hectares, and if so, whether the claimant was required to carry out earthworks beyond the area of the earthworks permit by the respondent.	The earthworks permit of 12 January 2011 was restricted to an area of 8.5 hectares. The claimant was required by the respondent to carry out earthworks beyond the area of the earthworks permit.
Question 3	**Finding**

JOBNAME: No Job Name PAGE: 7 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

Whether the respondent represented to the claimant that it will apply to revise the earthworks permit dated 12 January 2011.	The respondent represented to the claimant that it would apply to revise the earthworks permit dated 12 January 2011.
Question 4 Whether the claimant failed to progress sufficient key preparatory work activities which formed part of the subcontract works which enable the claimant to commence earthworks as at 31 December 2010.	Finding *
Question 5 Whether the claimant was able to commence earthworks before 12 January 2011 and/or 17 January 2011?	Finding *
Question 6 Whether the earthworks permit dated 19 August 2011 constituted a new earthworks permit of a continuing earthworks permit.	Finding The earthworks permit dated 19 August 2011 was, in terms, a continuing earthworks permit. There was a gap of time between the expiry of the validity of the earthworks permit of 12 January 2011, and the issue of the earthworks permit dated 19 August 2011.
Question 7 Whether the claimant is estopped from arguing that subcontract works were unlawful and/or illegal	Finding The claimant is not estopped from arguing that subcontract works were unlawful and/or illegal.
Question 8 Whether the claimant was entitled to issue the notice of withdrawal from the subcontract on 24 May 2011 and to determine the subcontract	Finding The claimant was not entitled to issue the notice of withdrawal from the subcontract on 24 May 2011 and was not entitled to determine the subcontract.

JOBNAME: No Job Name PAGE: 8 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

Question 9	Finding
Whether the respondent was entitled to issue a letter determining the subcontract on 30 May 2011 and/or did the acts and/or omission of the claimant amount to a repudiation of the subcontract which was accepted by the first respondent.	Correspondingly, the respondent was entitled to issue a letter determining the subcontract on 30 May 2011 since the refusal of further performance of the subcontract by the claimant and the withdrawal from the subcontract amounted to a repudiation of the subcontract which repudiation was accepted by the respondent.
Question 10	Finding
Whether the claimant to entitled to claim for the unpaid claims costs and retention as set out at paras 34.1–34.3 of the request for arbitration.	The claimant is not entitled to claim payment of the unpaid claims costs and retention as set out at paras 34.1–34.3 of the request for arbitration.
*174. In light of our finding that the claimant was not entitled to withdraw from the subcontract in the manner that it did, the tribunal finds it unnecessary to answer Questions 4 (whether the claimant failed to progress sufficient key preparatory work activities which formed part of the subcontract works which enable the claimant to commence earthworks as at 31 December 2010) and 5 (whether the claimant was able to commence earthworks before 12 January 2011 and/or 17 January 2011) for the purposes of this partial award and we therefore presently decline to do so.	

[12] As a consequence of this second partial award, the parties are now at the final stage of the arbitration where the arbitral tribunal will now hear evidence and decide on the quantum of damages as claimed by the defendant.

[13] On 4 July 2013, the defendant gave the plaintiff a written notice of its intention to receive the monies under the performance guarantee. This led the plaintiff to filing this second application. At the commencement of these proceedings, the parties agreed that the court hear the substantive application given that the orders sought in the interim are exactly the same as those sought substantively.

[14] In respect of the arbitral tribunal's opinion that the plaintiff should have suspended works under the subcontract instead of terminating the subcontract, the plaintiff submitted that suspension was not an option to the plaintiff. It offered six reasons for this upon which the plaintiff argued meant that the defendant was estopped by their conduct from claiming that the

JOBNAME: No Job Name PAGE: 9 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

plaintiff ought to have suspended works. The plaintiff submitted that it determined the subcontract only because it was made to understand that the defendant was not agreeable to a suspension of works. Those six reasons were:

(a) the plaintiff was concerned over the legality of their presence on site as at the material time, there was no proper earthworks permit in place;

(b) without a valid and proper earthworks permit, the plaintiff may be trespassing at the site of the project;

(c) without a valid and proper earthworks permit, the plaintiff is exposed to liabilities as the insurance policies taken against the machineries and workmen would be rendered void and null;

(d) the defendant had refused to instruct the plaintiff to suspend works over the issue and/or dispute relating to the earthworks permit;

(e) the defendant had made it clear that they will find the plaintiff in breach of the subcontract should the plaintiff suspend works; and

(f) prior to the plaintiff terminating the subcontract, the plaintiff requested that the defendant gives instructions to suspend works. However, the defendant refused to give such instructions.

[15] Learned counsel for the plaintiff argued that the performance guarantee serves to secure performance of the subcontract. This can be seen from the terms of the subcontract, specifically cl 22 (see p 1455). That clause provides that the plaintiff 'shall provide security for his proper performance of the subcontract '. Since the subcontract had been terminated by the plaintiff, there was no performance left to secure.

[16] It was further argued that the performance guarantee was directly dependent on the subcontract because of its terms:

> At the request of the Sub-Contractor, we Alliance Bank Malaysia Berhad hereby irrevocably undertake to pay you any sum or sums not exceeding in total amount Ringgit Malaysia: One Million Five Hundred Thirty One Thousand Eight Hundred Seven and Sen Eighty Five Only (RM1,531,807.85), upon receipt by us your first demand in writing accompanied by the original Guarantee and a written statement stating that the Sub-Contractor is in breach of its obligation(s) under the Sub-Contract, without you needing to prove or to show grounds for your demand or the sum specified therein.

[17] From these terms, it was submitted that the release cannot be made unless it was shown that the plaintiff was in breach of its obligations to the defendant.

[18] On this matter of breach, learned counsel for the plaintiff argued that

JOBNAME: No Job Name PAGE: 10 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

because the plaintiff was prevented from performing its obligations under the subcontract due entirely to the fault of the defendant, it is unconscionable for the defendant to now demand that monies be released to them under the performance guarantee. The plaintiff went on to say that 'the Defendant knew as early as March 2012 that there was no proper earthworks permit in place to enable the Plaintiff to commence earthworks but said nothing to the Plaintiff'. Learned counsel submitted that 'In furtherance of their mala fides conduct', the defendant 'took the position that no earthworks permit was required for the access road whilst taking steps to apply for the August EP without knowledge of the Plaintiff'. It was therefore 'unfair for the Plaintiff is the defendant is allowed to receive monies under the performance guarantee when the Defendant's mala fide conduct that prevented the Plaintiff from performing its obligations under the Sub-Contract'.

[19] In short, since the arbitral tribunal had found that it would be illegal for the plaintiff to carry on with the works without an earthworks permit, it was unconscionable for the defendant to now call on the performance guarantee, particularly in line with the conduct recognised by the arbitral tribunal. The plaintiff cannot be asked to carry on illegally. This was said to be contrary to the public policy of Malaysia.

[20] Learned counsel for the plaintiff candidly informed the court that the plaintiff was before the court instead of attending before the courts in Singapore (where the seat of arbitration is) because of the position of which country's public policy was to apply. He argued that the law as it stands in Singapore meant that it will be the public policy of Singapore instead of Malaysia.

[21] He further added that it will be too late to wait till a challenge under s 38 of the Arbitration Act 2005 ('Act 646') when the defendant is before the court for a registration and recognition of the final award as assessment of damages are afoot. By that time, the performance bond would have been paid up and there will be no real redress in terms of costs.

[22] He also candidly admitted that this was a 'backdoor' challenge of the arbitral award where the court is invited to look at the question of termination all over again. He argued that there is no bar to the court looking at the same point that the Arbitral Tribunal determined; this time in the Malaysian context. Finally, as mentioned at para 8 of the originating summons, the plaintiff advised that it 'will take the necessary steps to challenge and/or review the second partial award in the Singapore Courts'.

[23] By reason of all these explanations, the plaintiff claimed that the defendant was not entitled to receive any monies under the performance

JOBNAME: No Job Name PAGE: 11 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

guarantee as the subcontract had been rendered null and void under Malaysian laws. The declaratory orders and the injunction sought should therefore be granted.

[24] In response, the defendant argued that the present application is the 'latest in a series of spurious applications by the Plaintiff'. Aside from the earlier application which had resulted in the consent judgment, it seems the plaintiff had also applied in the High Court of Singapore to overturn a negative jurisdictional ruling by the arbitral tribunal. That application was struck out with costs on the basis that it had no prospect of success.

[25] The defendant contended that there was no legal basis for this application as in substance; this is a case of a plaintiff disagreeing with the second partial award. In that award, the arbitral tribunal had determined that the plaintiff was in breach of the subcontract.

[26] Learned counsel submitted that since the performance guarantee is an unconditional demand guarantee which is independent of the underlying subcontract, then the fact that the plaintiff disagrees with the second partial award is really irrelevant to the present question of whether the defendant is entitled to payment under the performance guarantee – see *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd* [1995] 1 MLJ 149. With the added feature of the existence of a breach of the subcontract having already been referred to arbitration, an injunction was inappropriate following the Court of Appeal's decision in *Cygal Berhad v Bandar Subang Sdn Bhd* [2004] 3 CLJ 67.

[27] The defendant further contended that the plaintiff was only entitled to prevent the defendant from receiving payment under the performance guarantee if it can prove fraud or unconscionability. The test is one of placing sufficient relevant and material evidence before the court to show that there is a seriously arguable case that the only realistic inference is the existence of unconscionability. According to learned counsel for the defendant, 'Patently, a disagreement with the second partial award is not sufficient basis for an allegation of fraud or even unconscionability'.

[28] Learned counsel added that no explanation or evidence has been proffered as to why the demand is fraudulent or unconscionable. Given that the defendant had paid for the performance guarantee in the first place, it is entitled to make a demand for payment under the terms of the guarantee. All that is required is a written statement from the defendant that the plaintiff is in breach of its obligations under the subcontract. The defendant is not required to provide any proof of this breach.

JOBNAME: No Job Name PAGE: 12 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

[29] In any case, even accepting for the sake of argument that the plaintiff's objections to the award is justified, the defendant's submitted that the defendant's demand which follows in the wake of the second partial award cannot be said to be unconscionable conduct warranting the orders sought.

DETERMINATION OF THE COURT

[30] In this originating summons, the plaintiff is seeking declaratory orders that the performance guarantee is null and void; that the defendant is not entitled to receive the monies under the guarantee; and that the defendant is restrained from receiving such monies. These are the principal orders:

(a) a declaration that the bank guarantee (the performance guarantee) issued by Alliance Bank (M) Bhd be null and void;

(b) a declaration that the defendant is not entitled to receive the sum of RM1,531,807.85 or any sum whatsoever under the performance guarantee from Alliance Bank (M) Bhd; and

(c) an order restraining the defendant whether by itself or by its agents or servants from receiving payment of the sum of RM1,531,807.85 or any sum whatsoever under the performance guarantee from Alliance Bank (M) Bhd.

[31] The grounds supporting the application can be found at para 7 of the originating summons which are set out as follow:

> 7 The defendant is not entitled to receive the monies under the performance guarantee for the, amongst others, following reasons:
>
> 7.1 with reference to the 2nd Partial Award, at the time of termination of the Sub-Contract, the Tribunal has held that there is no valid and/or proper earthworks permit in placed to enable the Plaintiff to conduct earthworks legally within the confines of the Malaysian laws;
>
> 7.2 hence, the Plaintiff cannot be faulted for not conducting earthworks at the material time as any earthworks conducted would have been illegal;
>
> 7.3 it was the Defendant who is responsible to obtain the earthworks permit and the Original Earthworks Permit does not permit the Plaintiff from carrying out the earthworks for the entire Ulu Jelai Project;

JOBNAME: No Job Name PAGE: 13 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

7.4 the performance guarantee is to guarantee the performance of the plaintiff and due to the lack of a valid and proper earthworks permit, the Plaintiff was prevented from performing its obligations under the Sub-Contract due to the fault of the Defendant;

7.5 the Tribunal opined that the plaintiff should have suspended works. However, suspension of works was not an option to the Plaintiff for the following reasons:

7.5.1 the Plaintiff was concerned over the legality of their presence on site as at the material time, there was no proper earthworks permit in place;

7.5.2 without a valid and proper earthworks permit, the Plaintiff may be trespassing at the site of the Project;

7.5.3 without a valid and proper earthworks permit, the Plaintiff is exposed to liabilities as the insurance policies taken against the machineries and workmen would be rendered void and null;

7.5.4 the Defendant had refused to instruct the plaintiff to suspend works over the issue and/or dispute relating to the earthworks permit;

7.5.5 the Defendant had make it clear that they will find the Plaintiff in breach of the Sub-Contract should the Plaintiff suspend works;

7.5.6 prior to the Plaintiff terminating the Sub-Contract, the Plaintiff has requested that the Defendant gives the instructions to suspend works. However, the Defendant refused to give such instructions,

7.6 the Defendant is estopped by their conduct from claiming that the plaintiff ought to have suspended works;

7.7 further, it is also absurd to expect the Plaintiff to adopt the 'wait and see' approach as opined by the Tribunal as the Defendant had already made it clear that they are of the view that an earthworks permit is not needed which the Tribunal subsequently found their contention is wrong. At the material time, the Defendant had no intention at all to rectify the illegality and in fact, they had admitted that they continued with the earthworks without an earthworks permit;

7.8 thus, the Defendant is not entitled to receive any monies under the Performance Bond as the Sub-Contract has been rendered null and void under the Malaysian laws.

JOBNAME: No Job Name PAGE: 14 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

[32] The law on the performance guarantees, performance bonds and the like is fairly well-settled. To start with, the performance guarantee is a contract entirely separate from the subcontract. It is a contract between the plaintiff and the bank. While the defendant may have paid for the guarantee, it is no less a contract between the bank and the plaintiff. This was the clear decision in *Hemis Interco BV Sdn Bhd v Syarikat Pembenaan Hashbudin (M) Sdn Bhd* [1986] 1 MLJ 245; [1986] 1 CLJ 562 where VC George J (as he then was) followed the principles laid down in *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 QB 159 and *Harbottle v National Westminster Bank* [1977] 2 All ER 862. This principle has been approved by the Supreme Court in *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd*.

[33] In *Esso Petroleum Malaysia Inc*, p 157, the Supreme Court found that the performance bond in that case was 'on a true construction, a pure on demand guarantee, and ail that was required to trigger it was a demand in writing'. These were the relevant terms of that performance bond:

> In consideration of Esso Petroleum Malaysia Inc agreeing to release to the sum of being the amount of liquidated damages we hereby unconditionally and irrevocably guarantee the payment to EPMI, the ringgit equivalent of the sum of
>
> This guarantee shall be effective from and shall remain valid, binding and in force for a period of from All claims, if any, in respect of or under this guarantee must be made in writing and received by us at any time on or before the expiry of this guarantee.
>
> This guarantee shall be governed by and construed in all respects in accordance with the laws of Malaysia and the parties hereto hereby submit to the jurisdiction of the courts in Malaysia in all matters connected with our obligations.

[34] Looking at the terms of the performance guarantee in our present case (which were set out earlier), it is clear that it, too, is an on demand guarantee. All that is required to set the obligations of the bank in motion is a written demand accompanied by the original performance guarantee and a written statement stating that the subcontractor is in breach of its obligation(s) under the subcontract. The defendant has done that and in recognition of conventional practice in the world of commerce and the crucial role played by performance guarantees or bonds, the undertaking or solemn promise which rests on trustworthiness, must be honoured.

[35] That irrevocable promise to pay or meet the demand must be honoured and no restraining orders ought to be made save in very limited circumstances and conditions. Those circumstances or conditions being where there is fraud or where it is proved present this element of unconscionability. Although the latter ground is one of fact, it must be such that which would 'prick at the conscience'.

JOBNAME: No Job Name PAGE: 15 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

[36] In *Sumatec Engineering and Construction Sdn Bhd v Malaysian Refining Co Sdn Bhd* [2012] 4 MLJ 1, the Federal Court had occasion to address the issue of unconscionability as a separate and distinct ground to restrain a beneficiary from making a call on a performance bond. It will be seen that the allegations were founded on the conduct of the respondent in that case as amounting to unconscionable conduct – see para 7 at p 7.

[37] At p 11, there is clear pronouncement and support from the Federal Court on the principle that:

> The fundamental principle behind a bank guarantee is that it is separate and independent of the underlying contract between the disputing immediate parties and the contract between the account party and the bank. Thus in this case, MRC could, relying on this autonomy principle, call upon BIMB to make payment on the bank guarantee at any time and without proof of any breaches arising from the underlying contract.

[38] Having said that, the Federal Court nevertheless recognised that the 'rigidity' of what it referred to as 'this autonomy principle' could sometimes 'produce injustice'. For a long while, the English courts have recognised the 'single exception of fraud' to counter any injustice that may arise from a call or payment on bank guarantee. The persuading reason behind this recognition is that the 'certainty of payment to the beneficiary under the autonomy principle has tipped the balance of risk heavily in favour of the beneficiary, sometimes resulting in inequitable result to the account party whilst achieving the desired commercial result '.

[39] The exception is rooted in the principle or maxim of *ex turpi causa non oritur actio* (no action arises out of a dishonourable cause). The 'fraud exception is thus recognised to balance the risks between the parties'. Kerr J, too, recognised this in *RD Harbottle (Mercantile) Ltd and another v National Westminster Bank Ltd and others* [1977] 2 All ER 862 where His Lordship said that it was:

> only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not concerned with the difficulties to enforce such claims; these are risks which the merchants take.

JOBNAME: No Job Name PAGE: 16 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

[40] Further passages from the English Court of Appeal's decision in *Edward Owen* expressing similar views were then cited. The Federal Court next examined and reviewed a line of authorities in various jurisdictions including Singapore and locally before concluding that it was prepared to accept unconscionable conduct as an additional basis of challenge. Those decisions include the Supreme Court's decision in *Esso Petroleum Malaysia Inc v Kago Petroleum Sdn Bhd*; and the Court of Appeal's decisions in *Kejuruteraan Bintai Kindenko Sdn Bhd v Nam Fatt Construction Sdn Bhd & Anor* [2011] 7 CLJ 442, and *LEC Contractors (M) Sdn Bhd (formerly known as Lotteworld Engineering & Construction Sdn Bhd) v Castle Inn Sdn Bhd & Anor* [2000] 3 MLJ 339; [2000] 3 CLJ 473. The Federal Court's decision in *Sumatec* was timely and it brought us together with other jurisdictions – see for example *Samwoh Asphalt Premix Pte Ltd v Sum Cheong Piling Pte Ltd & Anor* [2002]1 SLR 1.

[41] The Federal Court noted however that the matter of unconscionability as a distinct ground to restrain a call on a performance bond was not discussed in *LEC Contractors (M) Sdn Bhd v Castle Inn Sdn Bhd & Anor*. The Court of Appeal was there concerned with the requirement that the allegation of fraud must be specifically pleaded and proved. In that case, the court found not only was the allegation not pleaded, the instances of fraud were 'clearly not instances of fraud but dispute between parties'.

[42] From the Federal Court's decision in *Sumatec*, it can be said that the plaintiff will have to establish a 'strong prima facie case' with relevant material facts that there is a 'seriously arguable and realistic inference' of the existence of unconscionable conduct. These facts must be 'of such a degree such as to prick the conscience of a reasonable and sensible man'.

[43] Aside from the performance guarantee in this case being a separate contract between different contracting parties, it is quite clear from its terms that it is an unconditional guarantee – see also Court of Appeal's decision in *Karya Lagenda Sdn Bhd v Kejuruteraan Bintai Kindenko Sdn Bhd & Anor* [2007] 6 MLJ 72; [2007] 6 CLJ 18. However, contrary to the plaintiff's suggestion that before the demand can be made, it has to prove the reason for its demand. All that is required in the terms of the performance guarantee is a written demand 'accompanied by the original guarantee and a written statement stating that the Sub-Contractor is in breach of its obligation(s) under the Sub-Contract'. There is no need for the defendant 'to prove or to show grounds for your demand or the sum specified therein'.

[44] That has clearly been done here. Once that written demand with the appropriate statement is given, the performance guarantee is activated and the obligations therein must be met.

JOBNAME: No Job Name PAGE: 17 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

[45] Now, applying the tests prescribed in *Sumatec*, with respect, it is extremely difficult to see how the circumstances and conditions under which the plaintiff is making its case can meet those requirements. It is quite evident that the plaintiff does not agree with the arbitral award. Its argument that it cannot be right that the arbitral tribunal can, on the one hand agree with the plaintiff on the matter of the earthworks permit; yet on the other hand find that the plaintiff had no right to terminate but only to suspend the works under the subcontract, which is then a decision which violates public policy; is not an argument that can be properly taken in these proceedings. That is a matter for the curial law to determine having regard to the law of the arbitration agreement and the substantive law of the subcontract. I understand that action is afoot in that respect.

[46] What is most important are the terms of the consent judgment that was recorded before me in the first set of proceedings when the demand was first made on the performance guarantee. Those terms can be seen in exh 'TTC38' (p 2735 for the English text) to the affidavit affirmed by Tan Tang Chai on 9 July 2103 and filed in support of the present application. It is necessary that those terms be set out:

> UPON THE ORIGINATING SUMMONS dated 22.3.2013 AND UPON HEARING Mr. Gideon Tan (Miss Irene Wong together with him) solicitors for the Plaintiff and Mr. T. Kuhendran (Mr. Mohd Zayd together with him) solicitors for the Defendant BY CONSENT IT IS ORDERED that:
>
> (a) the Defendant be allowed to demand for payment from Alliance Bank Malaysia Berhad under the Bank Guarantee No ('the performance guarantee') issued by the Alliance Bank Malaysia Berhad;
>
> (b) the Defendant be restrained whether by itself or by its agents or servants from receiving payment of the sum of or any sum whatsoever under the performance guarantee issued by the Alliance Bank Malaysia subject to paragraph (c) below;
>
> (c) in the event that the Defendant intends to receive payment as described in paragraph (b) above, the Defendant shall provide 7 days written notice of its intention to the Plaintiff which written notice shall be provided within 28 days from the publication of the partial award relating to the issues on liability in Procedural Order and
>
> (d) no order as to costs.

JOBNAME: No Job Name PAGE: 18 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

[47] Evidently and undisputedly, the defendant's demand on the performance guarantee flows or arises under the award. That is unchallengeable. Such circumstances do not and cannot amount to unconscionability; nor do they come anywhere near. Certainly, not on the burden expressed by the Federal Court in *Sumatec*. Surely something more is required. Otherwise it would be so easy to make what is obviously a very serious charge. There must be some fact, material and relevant to show the unconsionability of the demand.

[48] Here, the demand followed in the wake of the arbitral award which was rendered in the defendant's favour. The plaintiff is not alleging that the plaintiff is acting unconscionably in making that demand. It is simply setting out the grounds or reasons from the second partial award, why it is wrong and that it disagrees with the arbitral tribunal; and concluding that it would be unconscionable in such circumstances for the demand to be met. To prevent that demand, it seeks the declaratory orders that the performance guarantee is null and void and that the plaintiff is not entitled to receive monies under the performance guarantee.

[49] I fail to see how the reasons or circumstances described by the plaintiff can render the performance guarantee null and void. That contract is perfectly valid and remains so whatever the outcome of the arbitral proceedings.

[50] In any case, I cannot see how demanding on a guarantee which in the first place is not dependent on proof of breach can be said to be an unconscionable act. The fact that the arbitral proceedings have yet another phase to deal with, that is the assessment of damage claimed by the defendant is unaffected by this.

[51] As mentioned, the demand is in keeping with the terms of the consent judgment and is consequent to the award which is rendered in the defendant's favour. That award remains good unless and until it is successfully challenged and set aside. Until then, the defendant has every right to call on the performance guarantee. These circumstances cannot and do not come close to amounting to 'strong prima facie case' or be 'of such a degree such as to prick the conscience of a reasonable and sensible man'. The plaintiff has therefore not discharged the burden that it bears.

[52] In the premises, the matters sought in the originating summons must be dismissed with costs. The defendant has sought costs be ordered on an indemnity basis given the course of conduct of the plaintiff; and that there was no basis for the injunction in the first place, that it was an exercise in futility and because extensive records had to be placed before this court. With respect, I am

JOBNAME: No Job Name PAGE: 19 SESS: 1 OUTPUT: Fri Jul 25 12:21:56 2014

not so inclined. I shall order costs of RM50,000 as reasonable and suitable costs to be paid to the defendant on a party and party scale.

Application dismissed with costs of RM50,000.

Reported by Kanesh Sundrum